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The Honorable City Council
of the City of Rialto, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Rialto, California (City) as of and for the year ended June 30, 2009, which collectively comprise the City's basic financial statements, and have issued our report thereon dated February 22, 2010. Our report included an explanatory paragraph describing the implementation of a new accounting standard. In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting.

We noted certain matters involving the internal control over financial reporting and its operation that we considered to be control deficiencies under auditing standards generally accepted in the United States of America.

ASSESSMENT OF INTERNAL CONTROLS

The City has a fiduciary responsibility as a steward of public funds. In order to fulfill this responsibility, the City has implemented internal controls that serve as the first line of defense in safeguarding assets. Additionally, these controls are designed to ensure: (1) effective and efficient operations, (2) reliable financial reporting and (3) compliance with applicable laws and regulations.

The Committee on Sponsoring Organizations of the Treadway Commission (COSO) has established a nationally recognized framework for internal control in its *Internal Control - Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting*. The COSO framework establishes five elements of internal control: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. Risk Assessment and Monitoring are integral parts of internal control and management should periodically evaluate the risks and monitor the changes facing the City. This process involves evaluating both previously identified risks and potential new risks and providing assurance that (1) controls are designed properly to address significant risks and (2) controls are operating effectively.

Effective for the 2008 audit, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) adopted a set of eight Statements of Auditing Standards (SAS No. 104 through 111), which, among other things, require auditors to assess an organization's design of controls and determine whether the controls have been placed in operation for all elements of internal control over financial reporting. If controls do not exist, are poorly designed or not operating effectively, the auditor must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weaknesses.

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In response to these new standards, for our 2008 audit we recommended the City's management document its internal controls over significant accounting areas (e.g cash receipts, cash disbursements), review and expand its existing internal control assessment process, and formalize a comprehensive risk assessment plan, which would include monitoring the adequacy and effectiveness of internal control procedures.

We recommend the City continue to build on its initial assessment and evaluate the risks of the City's operating environment. The City should also develop a written contingency plan relating to the City's Information Technologies (IT) processes. In the event of loss of City staff or ability to process IT normally, the City should have a written plan to ensure that IT functions are not interrupted.

Management response

Staff has taken the necessary steps to implement the audit suggestions from the management letter for fiscal year ending June 30, 2008. For June 30, 2009, staff has examined the circumstances and conditions that caused the misstatements identified in the SAS 114 letter. The primary circumstance resulted from changes in year end procedures to achieve a more compacted audit preparation timeline. The City understands the misstatements, made the appropriate corrections, concurs with the auditors' recommendation and will improve the documentation and review of year end processes.

INFORMATIONAL COMMENTS

New Government Auditing Standard (GASB) Statement No. 51 *Accounting and Financial Reporting for Intangible Assets*

In June 2007, GASB issued Statement No. 51, Accounting and Financial Reporting for Intangible Assets. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. Application of this statement is effective for the City's fiscal year ending June 30, 2010.

New Government Auditing Standard (GASB) Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments*

In June 2008, GASB issued Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. The Statement specifically requires governments to measure and report most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The requirement of reporting the derivative instruments at fair value on the face of the financial statements gives the users of financial statements a clearer look into the risks their governments are sometimes exposed to when they enter into these transactions and how those risks are managed. The Statement also addresses hedge accounting requirements and improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. Application of this Statement is effective for the City's fiscal year ending June 30, 2010.

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New Government Auditing Standard (GASB) Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions

In February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. GASB Statement No. 54 significantly changes the accounting and financial reporting for the City's fund balance classifications and categorization of individual funds. This standard requires the City to evaluate and recast its fund balance classification based on a hierarchy weighed on the extent to which the City is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This standard also provides guidance for classifying stabilization ("rainy day") amounts on the face of the balance sheet and would require disclosure of certain information about stabilization arrangements in the notes to the financial statements. In addition, the definitions of individual governmental fund types have been clarified whereby the City's use of special revenue funds and capital project funds could be recast. It is possible that this standard will change the City's current fund structure and this standard should be reflected in the City's June 30, 2011, operating budget. The requirements of this standard are effective for the fiscal year ending June 30, 2011.

American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (the Recovery Act) provides approximately \$300 billion dollars in additional federal funds which will be passed down from federal agencies to state and local governments and institutions of higher education. These federal funds are intended to either supplement existing federal programs, create new programs, or to provide more broad fiscal relief.

The Recovery Act mandates that there be an unprecedented amount of oversight and transparency over the spending of all funds associated with it. The Office of Management and Budget (OMB) set up a website to be the central point for the transparency part of the mandate. Also, the OMB issued guidance to the federal agencies regarding how they should carry out programs and activities relating to the Recovery Act that promotes timeliness and accountability. The OMB guidance addresses many issues and responsibilities including the following:

- Recipients are generally required to clearly distinguish Recovery Act funds from non-Recovery Act funds.
- New programs or existing programs that have significant changes in compliance requirements will be identified with a new Catalog of Federal Domestic Assistance (CFDA) number.
- Federal agencies designated Recovery Act programs as high-risk for single audit purposes.
- There is extensive quarterly reporting to federal agencies required from recipients of Recovery Act funding, which will be due within 10 days of each calendar quarter-end.
- Federal agencies are required to initiate additional oversight to address the unique implementation risks of the Recovery Act. The expectation in this area is that federal agencies will establish defined strategies to prevent or timely detect waste, fraud, or abuse.
- Federal agencies will also use the single audit process as a means of promoting accountability for Recovery funds.
- The Federal Audit Clearinghouse (FAC) is also required to make publicly available on the internet all single audit reports filed with the FAC for fiscal years ending September 30, 2009, and later.

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Based on the information above, it is clear the Recovery Act funds will have a significant impact on your single audit. While the Recovery Act did not have an immediate impact on your June 30, 2009 single audit, it is likely that it will have a significant impact over the following two fiscal years. Therefore, the City should begin planning and assessing risks associated with the receipt, spending and reporting of Recovery Act funds. Specifically, you should consider the following:

- Whether control procedures in place over federal expenditures are appropriate, operating effectively, designed to detect and prevent unallowable expenditures, and designed to detect or prevent fraud and abuse.
- Whether the existing staffing resources are adequate to address the increased reporting and monitoring requirements as a result of the Recovery Act. Also, the City should identify individual(s) who will monitor requirements and provide consistent guidance to the organization.
- Whether additional controls and system requirements will be needed to ensure that Recovery Act funds can be separately identified and tracked.
- Whether new controls will need to be established to meet the stringent reporting requirements to federal agencies.
- If Recovery Act funds will be passed down to subrecipients, that controls are in place to ensure appropriate subrecipient monitoring and also whether any new controls will need to be established related to new subrecipient reporting responsibilities.

The City's management responses to our comments from our audit are disclosed above. We did not audit the City's responses and accordingly express no opinion on them.

This report is intended solely for the information and use of the City Council, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would like to express our appreciation for the courtesy and assistance extended to us during our audit by all of your staff.

We would be pleased to discuss with you at your convenience the matters contained in this letter or any other matters which you would like to discuss.

Macias Tini & O'Connell LLP

Certified Public Accountants
Newport Beach, California

February 22, 2010